

Minutes for Task Force II July 16, 1997

The above referenced Task Force (and other interested parties) held its scheduled teleconference on July 16, 1997 at 1:00pm eastern time. Cass Vickers notified the group that he was serving as Michael Madsen's alternative as group co-leader. The following people were present: Cass Vickers, Alan Friedman, Lane Braunberger, Merle Buff, David Levine, Kendall Houghton, Larry O'Nan, Richard Pomp, Sue Haffield, Roxanne Davis, David Bauer, John Sagaser, René Blocker, Marilyn Hill and Paul Mines.

No comments were received during the public comment period.

To begin the meeting, the group asked for a two part summary of the prior meetings. The first part covered the issues raised in II.A.1. and II B.1. regarding whether the due process and commerce clause standards are satisfied by establishing that a sale occurred within the state. The second part, addressed later in the call, summarized the group's third issue regarding the indirect ownership of property in the state.

Summary of Past Discussion

Prior discussions of the first issue revolved around the definition of the term "sale". The current document refers to local law definitions. Since local law generally refers to a "sale" as the transfer of title, possession, or both, the group discussed that it is internally inconsistent. Past case law has referred to the credit mechanism provided in local law to avoid double taxation. In addition, cases could indicate that, for constitutional purposes, a sale is viewed in a more practical sense rather than via a definition. Different views have been expressed regarding whether a sale can occur concurrently in more than one state. In addition, the group had discussed whether the Quill Corporation case applied only to use tax collection. If so, one view is that when a state establishes that the sale occurred within the state, Quill would not apply. (Further detail for this summary can be found in the minutes of prior meetings.)

Current Discussion — Due Process

It was noted that the group was closer to consensus on the due process standard than the commerce clause standard. For due process purposes, the concept of "purposeful availing of the market" was discussed. The mere fact that a sale occurs within a state may not satisfy the due process standard if the sale was "accidental" rather than purposeful. The rogue salesperson example was used to discuss whether due process is "always" satisfied if a sale occurs within the taxing state. The following scenarios were discussed:

Scenario 1: A sales person enters a state, which is not part of his or her assigned territory. The company had previously determined not to enter that state's market due to other business factors (such as product liability). The sales person makes a sale.

Scenario 2: A sales person enters a state that is not part of his or her assigned territory. The company has no policy with respect to making sales in that state. The sales person makes the sale.

The group tentatively concluded that it is possible to a sale within the state and not meet the due process standard. The group discussed the idea of adding language to the document in II.A.1. that requires an analysis of the magnitude of the sale to satisfy the notions of substantial justice before concluding that the due process standard is met. The added language or “qualifier” could be similar to that contained in II.A.3. regarding use tax collection. However, the group has not resolved the definition of the term “sale”. Local law definitions generally refer to a transfer of title, possession or both. Concepts for defining sale we discussed as options include: 1) Wherever the first event occurs (transfer of title or possession), 2) Wherever the last event occurs, and 3) Consumer’s location. It was noted that the Supreme Court has never addressed this particular issue. One suggestion was made that the group ignore the “constitutional” definition of sale for the purposes of the first document and address it in the second document. The group did not reach a consensus on this suggestion as some feel that the first document refers to definitions and we should have a definition in that document.

We left the “due process” discussion with tentative consensus provided that the qualifier is added, the group agrees on the language of the qualifier, and that the group can reach a consensus on where the sale occurs. The MTC welcomed any suggestions regarding the wording of the revision.

Current Discussion — Commerce Clause

The Commerce Clause nexus standard is found in II.B.1. of the document. Again, the rogue salesperson examples were used for discussion purposes. The group discussed how elastic “rogueness” could be and whether it could be used to avoid tax in too many situations. We discussed whether a sales threshold should be used. The example was provided that sales of small dollar amounts could be viewed differently than a single large dollar sale. Some hold the view that a dollar threshold is not a constitutional issue, but a policy issue that should be left to the states to determine administratively. Some group members hold the view that a dollar threshold should not be used.

We discussed the concepts of substantial nexus versus the slightest presence. (Substantial nexus is required for commerce clause while slightest presence is a due process concept). We discussed the conscious submission to jurisdiction and whether ratifying the sale or accepting the profits (even by a rogue salesperson) was a conscious submission to jurisdiction. The group did not agree as to whether this was conscious submission. We also discussed whether the ability of the sales person to bind the company would be a factor in the nexus arena. The group did not reach consensus on this issue.

Indirect Ownership of Property

A summary of past discussion was provided for this issue. The most discussion revolves around the concept that nexus can be created for one legal entity by the indirect ownership of property of a related entity. For example, a parent company's property could create nexus for a subsidiary. National Geographic was interpreted to allow a state to look at the activities of one division of a company for the purposes of imposing tax on an unrelated division. The group also discussed the idea that National Geographic may require legal entities to be respected.

We discussed whether the concept generally applied in sales/use situations of form over substance would be respected. If so, legal entities would be respected. If not, indirect ownership could create nexus from a constitutional standpoint. Some view the form over substance issue as a "local law" concept and believe that the constitution would not prohibit a change to substance over form. Others hold the view that under *Silas Mason*, the Supreme Court has given indications that the "technicalities" in sales tax are to be taken seriously and respected.

We discussed similar ownership applications found in the Internal Revenue Code for federal income tax purposes. IRC concepts include an indirect ownership of property, and apparently there has been no constitutional difficulty in deeming that property of a subsidiary is indirectly owned by the parent. However, the group was not aware of cases where the Court addressed this issue.

The group questioned how foreign subsidiaries are treated with respect to property ownership. It was noted that the Subpart F rules contain some attribution guidelines regarding this matter.

We also discussed "affiliate nexus" with respect to whether the affiliate could be deemed an agent in the state.

The group did not reach consensus on this issue.

We made plans to meet in Whitefish, MT to continue the discussions of these matters. Based on response during the call, it appears a fair number of people will be present in Whitefish.